First, the Commission would adopt immediately a benchmark rate for basic and for expanded basic based on the Coalition's analysis of (1) rates in systems facing effective competition; (2) rates charged by municipally-owned systems; (3) studies quantifying the amount of monopoly rents in current cable rates; and (4) costs in several systems. This should result in reasonable rates now, but the Coalition believes that the method could be manipulated by operators and result in higher than appropriate rates if the method were applied for the long term.

Second, the Commission would commence a second rulemaking to establish industry norms for certain costs. These norms would then be applied by the franchising authority to identify a benchmark basic rate (which the franchising authority would enforce) and a benchmark expanded basic rate (which could provide the basis for complaints to the Commission).

Third, cable operators and cities would be permitted to enter into contracts establishing rates for basic cable, expanded basic and equipment. In effect, they would be able to "settle" rate issues by entering into binding rate agreements. As explained in Reply Attachment 1, and below, this approach serves all statutory goals, and need not result in undue burdens on the Commission.

A. The Coalition's Approach Offers <u>Subscribers Immediate Relief from Excessive Rates</u>

Almost all parties have recognized that it will be impossible to develop by April 3 any benchmark that depends on collection of significant amounts of new data. However, the Act requires that the FCC have in place by April 3 regulations that enable it to "carry out its obligations under paragraph (1)." § 623(b)(2), 106 Stat. at 1465-66. See also § 623(c)(1) and (h), 106 Stat. at 1468, 1470. Thus, the FCC cannot simply wait to enact regulations (as some industry commenters recommend[94]) until it has the opportunity to collect and evaluate information.

Studies that have considered cable costs estimate that 25 to 50 percent of current rates are attributable to monopoly profits.[95] To the extent that the industry even offers suggestions regarding interim rate regulations, it does not propose any method that will eliminate these monopoly rents. The Coalition believes it is critical to establish reasonable rates, by eliminating monopoly profits as quickly as possible.

The Coalition agrees with the study submitted by Time Warner, that the FCC may consider all the benchmark proposals and rely on some or all of them, or disregard them entirely and establish a different benchmark.[96] The Coalition did consider all of the benchmarks proposed by the FCC. It also considered studies and economic analyses of the cable industry, and has looked at a sampling of cost data. The data showed that rates need to be substantially reduced.

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[94] See Northland Communications Corporation at 7 (suggesting the FCC develop regulations on a gradual basis and take two to three years before implementing final regulations).

[95] Robert Rubinovitz, Market Power and Price Increases for Basic Cable Service Since Deregulation, U.S. Department of Justice, Antitrust Division, Economic Analysis Group (August 6, 1991).

[96] Time Warner study at 23.

Based on its evaluation, the Coalition determined that $0.32 per-channel is a reasonable rate for basic and expanded basic service.[97] This analysis is confirmed by other commenters. The Consumer Federation of America proposed to set rates by escalating 1986 rates. It calculated that on average, its study would result in a per-channel rate of approximately $0.34 to $0.40.[98] Studies of systems facing effective competition show average rates between $0.32 and $0.38 per channel.[99] See also Smith and Katz Comments Analysis at 10-12 (rate procedures proposed by Coalition and CFA yield reasonable results).

This interim benchmark would offer subscribers a significant amount of rate relief on April 3.

Given the data before it, the Commission has ample reason for concluding that a $0.32 per channel rate is not too low. In addition, the per channel rate as proposed by the Coalition is not subject to the same criticisms as the price-based approaches proposed by the industry.

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[97] See Coalition's initial comments, Att. 2 at 5. The Coalition's analysis ignores current rates in non-competitive communities, for reasons expressed in it comments at 43-46.

[98] Consumer Federation of America ("CFA") comments at 103. As a technical matter, under the CFA's proposal each franchising authority would establish a rate for its particular system by escalating 1986 rates for that community to an appropriate, per-channel rate considering price increases and channel capacity expansion.

[99] See also comments of the Attorneys General of Pennsylvania, Massachusetts, New York, Ohio and Texas at 6 (citing evidence reflecting that rates for competitive systems are 34 to 42 percent lower than average cable rates).

First, the industry proposes to use price based approaches to set rates for the forseeable future. As the NAB Study points out, over time it will be possible for the industry to manipulate pricing to distort the benchmark. NAB Study at 5-6. The Coalition's approach -- which could quickly give way to a cost-based benchmark method -- does not suffer from these problems, because the Coalition's estimate is based on historical price data that the industry would not have had the opportunity to manipulate.

Second, some commenters pointed out that, even setting aside potential manipulation problems, a per channel rate can lead to odd and inequitable results as systems change. For example, if an operator were allowed to charge an additional $0.32 every time it added a channel, an operator could drive up rates and increase profits by activating capacity and replaying the same text messages on each of the activated channels. Alternatively, high-cost existing networks could be removed in favor of low or no-cost programming. The Coalition proposes to avoid the problem initially by allowing franchising authorities to require operators to disclose any cost reductions, and by limiting increases in the rate established using the benchmark to provable (and defensible) increases in programming costs.[100] The problem is eliminated over the longer term by the movement to a cost-based benchmark approach.

[100] For example, a vertically integrated company could not obtain a rate increase by agreeing to pay itself more for its programming.

Third, the proposal does not encourage retiering to avoid regulation. An operator is not rewarded when a channel is placed on the expanded basic. Hence any decision to re-tier should be driven by customer preferences.

Fourth, the benchmark is in fact simple to apply, both to establish basic and to establish non-basic rates. The advantages above would also apply generally to the method proposed by the CFA, although that method would be somewhat more difficult to apply in communities which have not retained good records of 1986 rates.

B. A Cost-Based Approach Can and <u>Should be Used in the Long Term</u>

The Coalition does not recommend relying permanently on a simple per-channel rate. As noted above, the approach is logistically reasonable and fair in the short term, but loses strength over the long term, for a variety of reasons. For example, as the industry notes, per-channel costs generally decline as the number of channels increase.[101] While the Consumer Federation of America ("CFA") study has found a way to take this factor into account in translating 1986 rates to appropriate 1993 levels,[102] it still may not recognize that

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[101] Time Warner Comments at 23; Time Warner study at 28.

[102] CFA comments at 90-91.

there may be other changes in the market such that cable costs may actually decline in the future.[103]

The Coalition feels strongly that the Commission therefore should move to adopt an additional formula that would take costs of providing service into account in setting rates. According to Continental Cablevision, Congress left it to the FCC "to determine whether cable rate increases were out-of-line with cable cost increases."[104] The most accurate way to make such a determination in the future will be by looking at costs.

An adequate sampling of cost information must be considered to (1) determine the factors that result in cost differences and (2) enable a regulator to understand what a reasonable "benchmark" would be, based on the relevant factors of a particular system. This information can provide the framework for establishing reasonable rate levels. An individualized study of costs of service in every community is not necessary (although this option should not be precluded[105]).

A wide cross-section of commenters, representing many different interests, agree that over the longer term, the FCC should develop a regulatory process that includes cost considerations. CFA, for example, states that its past regulated rate method is best used only until the FCC can develop and

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[103] Comments of Attorney General of Pennsylvania, Massachusetts, New York, Ohio and Texas at 4.

[104] Continental Cablevision comments at 1-2.

[105] Coalition's initial comments at 48, 52-53 and discussion, _infra_.

implement a system of cost based regulation.[106] Comments filed by the National Association of Broadcasters ("NAB"), The NYNEX Telephone Companies, The Coalition of Municipal and Other Local Governmental Franchising Authorities, and others support the idea that cost data is essential to establishing a regulatory method that will achieve Congress' goals.

The method proposed by the Coalition has the important attributes of (1) accuracy and fairness to all parties; (2) ease of application; (3) flexibility; and (4) providing appropriate incentives. The model was set forth in the Appendix to the Coalition's initial comments, Attachment 1. It was described in those initial comments. Further discussion and explication of the model, in light of other comments filed in this proceeding, is included as Reply Attachment 1 to these Reply Comments.

In brief, the model proposed by the Coalition asks the FCC to collect cost data from a sample of cable operators, including those in communities where operators compete head to head. This data would be used to establish cost norms. The FCC would also develop an appropriate rate of return.

The franchising authority would plug these normative costs into the Coalition's model, along with objective, community specific data (e.g., number of plant miles, penetration, and number of customers) that determine the total revenue requirement (and cost allocations) for that community. The FCC would also have to determine the appropriate rate of return.

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[106] CFA comments at 85-87.

The model would provide a cost-based, reasonable benchmark rates for both basic and non-basic service tiers, allocating a proportionate amount of costs to each tier. The franchising authority could set the basic rate. A complaint showing the expanded basic rate exceeded the level predicted by the model would be sufficient to trigger further Commission review.

The proposed model could be applied in a number of ways. As noted above, more or fewer inputs could be made based on national norms (depending upon policy issues, and depending on whether the data shows that norms can be established for particular costs). Smith & Katz Comments Analysis at 10. The particular factors used to establish rates might be varied somewhat, to reflect or weight the criteria most important in determining costs.

Procedurally, too, the model allows for ease and flexibility. A single process derives benchmarks for all programming tiers. Thus, the franchising authority could identify the applicable non-basic benchmark. The FCC could encourage operators and franchising authorities to have subscribers notify the franchising authority if the subscriber intended to file a complaint.[107] The franchising authority would then inform the subscriber as to whether the non-basic rate exceeded the benchmark, and the corresponding implications. The

[107] Subscribers are likely to contact the franchising authority in any event before filing, to get advice and procedural information.

FCC could require the complainant to state whether the rate was above the benchmark.[108]

Establishing a single regulatory model that is applied to basic and non-basic services alike is beneficial for a number of reasons. First, as already mentioned, it substantially reduces administrative burdens. Second, it substantially reduces retiering incentives. Third, it is consistent with the CPCA, which in several cases effectively requires the Commission to consider the total price associated with basic and non-basic in setting non-basic rates. For example, Section 623(b)(2)(C)(iii) makes clear that fully allocable costs need not be included in basic service rates.[109] Joint and common costs should be recovered in rates of <u>all</u> cable services, not in basic rates alone.[110] The Conference Report makes clear that basic rates should not be used to subsidize unregulated services.[111] Likewise, Section 623(b)(2)(vii) considers whether cable operators earn a reasonable profit, consistently with the goal of ensuring reasonable rates. This provision was amended from previous language that looked only at whether operators received

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[108] The FCC should not automatically dismiss a complaint that a below-benchmark rate is in fact excessive, because where there is a misapplication of the benchmark, for example, the rate should be subject to review and possible increase or decrease. It would be reasonable, however, for the FCC to give priority attention to complaints on above-benchmark rates.

[109] House Conference Report at 63, 1992 U.S.C.C.A.N. at 1245.

[110] <u>Id.</u>

[111] <u>Id.</u> <u>See also</u> House report at 83, 1992 U.S.C.C.A.N. at 1265.

a reasonable profit from basic service.[112] In addition, Section 623(c)(2)(D) directs the Commission to look at rates "as a whole" (other than premium service rates) in determining if non-basic rates are unreasonable. The rate regulation provisions thus authorize and to a degree require rates, costs and profits to be considered collectively.

Many industry comments express concern that any cost-based approach is unfeasible because (1) it requires a uniform system of accounts which doesn't currently exist for the cable industry and which will take years to develop; (2) cost-based approaches are costly and time-consuming; (3) cost-based approaches provide disincentives for efficiency; and (4) cost-based approaches will prevent investment in programming. We respond to these claims <u>seriatim</u>.

1. A Uniform System of Accounts is NOT <u>Necessary to Implement the Coalition's Proposal</u>

In its initial comments, the Coalition asserted that the FCC would have to develop a uniform system of accounts to adopt the Coalition's model. The Coalition wishes to clarify that proper use of the model is <u>not</u> dependent upon a uniform system of accounts. This is because operators already collect data on a relatively uniform basis, so that data required to run the model is available.[113] Further, the industry is not so

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[112] <u>Id.</u>

[113] Indeed, operators often provide precisely the sort of data required for the model in connection with renewals, transfers and franchise fee audits.

complex that it is necessary to develop uniform accounting standards in order to allocate costs. Thus, the concerns expressed by Continental Cablevision and others regarding cost-methods that require a uniform system of accounts are not applicable with respect to the Coalition's model.[114]

The Coalition does believe that a uniform system of accounts would be useful for cross-system analyses. As the cable industry becomes more like the telephone industry, a uniform system of accounts may be needed to help allocate and track costs. Developing a uniform system of accounts should not be as difficult as Continental suggests, given that uniform accounting system for cable operators is already being used by New York State. The Coalition recommends that the FCC ultimately create a uniform system of accounts. However, that is an independent recommendation. Development of industry norms need not await the formulation of a uniform system of accounts. Smith & Katz Comments Analysis at 12.

2. The Approach Advocated by the Coalition is Easy to Apply

The proposed model is not unduly burdensome to administer, and certainly is less complex than the benchmark method proposed by NCTA.[115] It requires collection of data, as do all the proposed benchmarks. However, cost data, rather than

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[114] See, e.g., Comments of Continental Cablevision, Appendix A.

[115] See NCTA study and Coalition's discussion at Part I, supra.

price data, will be collected. The Coalition's model allows the FCC to analyze the data and determine appropriate benchmark categories for different costs, if multiple categories are warranted, or a single benchmark for each cost category. This is consistent with industry proposals.[116] Thus, the FCC can establish norms for costs (such as capital costs) that may be the most difficult costs to verify at the local level.[117]

The model uses a cash-flow accounting method, and thus minimizes certain accounting complexities and eliminates the need for depreciation analyses.[118] See, Smith & Katz.

The model is simple for franchising authorities to use. They simply plug in a handful of objective data - readily available from the local operator - to derive the appropriate benchmarks for the community.

NCTA goes to great lengths to argue that, if the Commission in fact adopts a regulatory model that may result in rollbacks in a significant number of systems, the FCC will be swamped with complaints that expanded basic rates are unreasonable. We have already pointed out that it is neither good policy nor good law to allow this proceeding to be driven by fears that it will accomplish something for consumers. We have also noted that the NCTA's own proposal, because it is so vague and indefinite, is

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116 See, e.g., Time Warner study at 21.

117 Shooshan, NAB Study at 6.

118 A cash-flow accounting is supported by at least one MSO. See Comments of Continental Cablevision, Appendix C.

very likely to lead to massive filings at the FCC, but will leave the FCC with no principled method for handling those complaints. We also believe that the procedural nightmares conjured by the NCTA are not realistic.

First, if an accurate benchmark is established -- as the Coalition proposes -- it will be simple to dispose of complaints. To the extent the benchmark is reasonable, and the operator is charging above benchmark level, the FCC can demand that an operator present detailed cost and revenue data that the rate is confiscatory as applied to it. If the Commission makes it clear that, when called upon to make such a showing, it may decide to uphold the benchmark, allow higher rates, or set lower rates, we suspect few operators will risk making frivolous filings.[119] The average consumer will certainly have little reason or incentive to file a frivolous complaint at the FCC.

Second, if cable operators refuse to abide by the benchmark for expanded basic -- so that complaints are filed in many communities, the Commission should be able to consolidate cases to minimize administrative burdens. For example, if a major MSO raised rates in all its franchise areas, the Commission could potentially consolidate all cases involving that Company, a tack that in fact will ensure the FCC has clear data on costs at the local level and parent company level, to the extent such costs affect rates. After conducting investigations on a company-wide

[119] In Gillette, Wyoming, for example, the City rolled back basic rates by almost $7.00 and the operator never claimed that the resulting rate was confiscatory.

level, the Commission could then easily resolve complaints in individual cases.[120] These proceedings could prove a significant source of data for establishing benchmarks.

In the long run, the Coalition's method reduces administrative burdens because the accuracy of the resulting benchmarks minimizes the bases for appeal.

It is important to emphasize that the Coalition does not believe that the cost-based benchmark approach should preclude franchising authorities from regulating rates by an alternative method that is "consistent with the regulation prescribed by the Commission . . . ." § 623(a)(3)(A), 106 Stat. at 1464. Other commenters also endorse this view.[121]

In particular, franchising authorities should be able to regulate rates using traditional cost-of-service methodologies, rather than benchmarks. Numerous comments support a cost-of-service option.[122] As we have shown above, the

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[120] The industry suggests that the requirement in the Cable Act that the Commission decide, in individual cases, whether a rate is unreasonable permits it to consolidate all cases in a given community. Likewise, at least where a company increases rates at the same time in many communities (as did TCI in January), it should be reasonable to decide all cases involving the same increase in one FCC proceeding.

[121] See Comments of the Attorney General, State of Connecticut at 6-7 (". . . Connecticut has always believed that such regulation is better left with the franchising authorities. . . .The Commission should leave the choice of basic service regulation to the States").

[122] See, e.g., Comments of The NYNEX Telephone Companies, comments of Media General, comments of Attorney General, State of Connecticut, comments of The Coalition of Municipal and Other Local Governmental Franchising Authorities.

difficulties of using cost-of-service regulation are drastically overstated in the industry's comments.[123] Certainly, in light of the high level of accuracy it provides, it should not be dismissed as an alternative where the franchising authority wishes to take additional efforts to achieve an equitable result.

3. **The Coalition's Proposal Offers <u>Incentives for Development and Efficiency</u>**

The industry argues that cost-of-service regulation encourages inefficient investment because all investments are included in the rate base (and justify a higher rate). It is also argued that traditional cost-of-service regulation can lead to operational inefficiencies. The claim is not accurate,[124] but most importantly it has no application to the Coalition's model, which sets rates based on industry benchmarks.

Cost-based benchmarks preserve incentives for operating efficiencies at least as well as price-based benchmarks. Smith & Katz, Comment Analysis at 5-7. High-cost operators do not recover excessive costs while more efficient operators can earn larger profits. Moreover, because the capital cost benchmark is derived from replacement costs, it will encourage a reasonable amount of investment. By contrast, if benchmarks do not reflect costs, there is little incentive for an operator to invest in

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[123] For example, both Austin, Texas and Wadsworth, Ohio (a community of 15,700) use cost-of-service methods to regulate utilities.

[124] The comments of The Coalition of Municipal and Other Local Governmental Franchising Authorities at 52 discuss cost-of-service incentives.

expensive but valuable technological improvements that might benefit subscribers but that would reduce operator profits under a non-cost-based approach.

Both price and cost-based benchmarks can create an incentive for the operator to reduce service quality to cut costs and increase profits.[125] The solution, however, is for the Commission to adopt stringent customer service standards and to make it clear that communities can respond to decreases in service quality by adopting additional standards, imposing penalties as contemplated by the franchise, and ultimately, by reducing rates.

4. The Model Need Not <u>Discourage Investment In Programming</u>

The industry also suggests that rate regulation will discourage investment in programming. Under the proposed model, that need not be the case: the Commission potentially could pass through all legitimate programming costs, assuming proper protections were put in place. If programming costs were passed through, investment in programming could not even arguably be affected by rate regulation.

The danger with a programming pass through (NAB Study, p. 8-9) is twofold. First, MSOs often purchase programming at the corporate level and then re-sell that programming to subsidiaries. If local system costs were determined by looking at the amount ostensibly paid from the subsidiary to the parent,

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[125] Smith & Katz, Comment Analysis at 6-8. The Coalition supports strong minimum technical and customer service standards.

MSOs could drive up rates simply by overcharging themselves for programming. To avoid this, the Commission would have to require companies to report the first cost paid for programming.

Similarly, many MSOs own interests in programmers. Those MSOs could agree to pay more to their affiliates, and thereby drive up their reported programming costs, without adversely affecting corporate profits. To prevent such self-dealing, the Commission would need to collect data on the amount paid by operators from programming last year, and then periodically review current service prices to determine whether there was any evidence that the operator was overcharging itself.

5. The Model Is Consistent With Other Approaches

The Coalition's model strikingly parallels the model proposed by the NAB in this proceeding. While there are some distinctions between the models (see Smith & Katz Comments Analysis at 12 n.29),[126] both models reach almost the same conclusion with respect to rates.

6. The Coalition's Proposal Provides a Systematic Approach to Variances in Rates

The CPCA states that cable operators must have a rate structure that is "uniform throughout the geographic area in which cable service is provided over its cable system."

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[126] Among the most notable differences: the NAB study would only establish a benchmark at the national level for capital costs. The Coalition believes other costs, such as operating costs can and should be benchmarked; this should reduce the possibility that, in particular locations, the operator will engage in creative accounting to drive up ostensible operating costs.

§ 623(d), 106 Stat. at 1469. Cable operators and industry organizations insist that the "geographic area" should be limited to the franchise area. Furthermore, these comments consistently argue that (1) operators should be able to charge different rates to different classes of subscribers (e.g., bulk rates versus individual rates, seasonal versus year-round subscribers, single family homes versus multi-dwelling units ("MDU's")); (2) operators should be able to lower rates in a portion of the franchise area to meet rates offered by a competitor; and (3) the provision does not prohibit promotional rates.

The cost-based approach proposed by the Coalition offers a simple, consistent response to all these suggestions, and is consistent with the plain language of the Act: different rates can exist only where they are justified by different total costs of providing service. The Act, on its face, is clear that a "geographic area" is larger than the franchise area where a cable system serves more than one community. Hence, all other things being equal, rates in communities served by the same system should be the same. Where things are not the same, the model would permit establishment of different rates.

If bulk, seasonal or cross-jurisdictional rate differences are not cost-justified, the rates are discriminatory and thus violate the Act. Continental Cablevision claims that MDU managers are accustomed to lower, bulk rates and will obtain service from Satellite Master Antenna Television ("SMATV") operators or will install their own systems rather than pay full price.[127] This suggests, however, that the rates charged to compete against SMATV or other competing providers may reflect the competitive rates that the operator should be charging throughout the area, and not just where it needs to price (and underprice) to stave off competition. The Act plainly prevents operators from reducing prices only in one portion of the franchise area to meet competition, at least where there is no cost-based reason for doing so.[128] This situation is a mirror image (on a larger scale) of the MDU rate-pricing scheme discussed above. Allowing an operator to reduce costs only where it faces competition entrenches that operator even more deeply into a comfortable monopoly position, and requires subscribers in other areas to subsidize the area facing competition, at least if the operator needs to price below costs to meet the competitor's rate. Of course, if Continental were in fact incurring lower costs in serving MDUs, a lower rate might be justified. That is not, however, Continental's claim: it argues that it was providing service to MDUs below cost,[129] but it certainly cannot

[127] Comments of Continental Cablevision at 65.

[128] The Conference Report to the CPCA does not explain the underlying basis for the uniform rate requirement in § 623(d), but merely notes that the language of the Senate bill was adopted. House Conf. Report at 61, 1992 U.S.C.C.A.N. at 1243. The Senate Report explains that the uniform requirement was "intended to prevent cable operators from dropping the rates in one portion of the franchise area to undercut a competitor temporarily." Senate Report at 76, 1992 U.S.C.C.A.N. at 1209.

[129] If Continental is asserting it knowingly engaged in predatory pricing to drive a competitor out of business, that is a serious matter.

ask other basic ratepayers to subsidize the cost of battling its competitors.

III. FCC RULES MUST FACILITATE RATE REGULATION

A. The Industry's Position Regarding Regulation of Equipment is at Odds with Both Statutory Language and Intent

The cable industry takes the approach that equipment is subject to regulation "on the basis of actual cost," pursuant to Section 623(b)(3) only where the equipment is used only to receive basic service. If the same equipment is used to receive both basic and non-basic services, the industry argues, Section 623(b)(3) does not apply.[130] A study submitted by Time Warner states, "Not regulating equipment unless it is necessary for receipt of basic service is consistent with the economic model of the 1992 Act. . . ."[131]

This position is directly at odds with the Act. Earlier versions of the CPCA included a requirement that the regulated equipment be "necessary" for receipt of basic service, but the requirement was specifically deleted. Conference Report at 64. The change was designed to give greater protection to subscribers. Id. Instead, equipment need only be "used" to receive basic service. § 623(b)(3), 106 Stat. at 1466. The plain language of the Act, as well as the legislative history, makes clear that any equipment used to receive basic service is

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130 NCTA comments at 49-51; Time Warner comments at 53.

131 Time Warner study at 35 (emphasis added).

subject to cost-based regulation, regardless of whether the same equipment is also used to receive non-basic service. Time Warner analogizes that, where a subscriber receives both basic and expanded basic service, only basic is subject to basic service regulatory provisions.[132] This merely proves the point: a subscriber is not exempt from basic rate regulation simply because he also receives expanded basic service. And in fact, the entire collection of services may be subject to rate regulation as basic service. American Civil Liberties Union v. FCC, 823 F.2d 1554, 1556 n.31 (D.C.Cir. 1987), cert. denied, 485 U.S. 959 (1988).

The industry also suggests that even basic equipment should be free from regulation if there is a "competitive market" for that equipment, and offers several bases for finding that such competition exists. These proposals are simply beyond the plain language of the Act. The Act defines "effective competition." § 623(l)(1), 106 Stat. at 1470. It does not provide for differing standards for equipment and other cable services. Moreover, Congress made clear that both basic and non-basic equipment must be rate-regulated to protect subscribers against market power abuse.[133]

Moreover, the fact that certain types of equipment may be available for lease or sale from independent sources is not dispositive. If a cable operator can require subscribers to

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[132] Time Warner comments at 54.

[133] Senate Report at 83, 1992 U.S.C.C.A.N. at 1216.

order equipment from the operator, either by bundling equipment with programming or by requiring the use of equipment that is not compatible with commercially available equipment, it will be able to charge excessive, noncompetitive rates. Thus, the fact that particular equipment is available elsewhere does not mean that the operator's equipment faces effective competition, as the industry asserts.[134] The rates for the equipment charged by retail outlets or other non-cable operators may, however, give a good indication of what competitive rates are.

The industry claims that Congress did not intend to prohibit bundling of equipment. Time Warner and Continental Cablevision state that operators should be able, for example, to bundle remote control devices and converters, even though the rates for remotes may be low and the rates for converters high. In fact, this is a perfect example of one reason not to permit bundling, because it would require subscribers who just want remotes to pay much more than they should. In addition, bundling discourages competition. For example, where a subscriber wants a converter and a remote, it will not purchase a remote from a competitor if a remote is included in the bundled equipment package offered by the operator, even if the competitor charges lower rates for the remote alone. While the industry disputes the issue, at least

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[134] Comments of TCI at 38-39.

some operators recognize that Congress sought to promote a competitive market for cable equipment.[135]

B. Contrary to the Industry, Regulations Regarding Effective Competition Should be Designed to Ensure Rate Regulation Where Rates Are Not at Competitive Levels

The Commission asks how to interpret or define the standards for "effective competition." Congress recognized both that rate regulation is imperative where there is not competition (§ 2(b)(4), 106 Stat. at 1463) and that rates should not be regulated where competition exists (§ 623(a)(2), 106 Stat. at 1464). The Coalition maintains that the crucial factor in determining whether there is effective competition is whether the existing environment results in actual competition, and competitive rates. This is consistent with the goals of the Act. § 623(b)(1), (b)(2)(C)(i), (c)(2)(B), 106 Stat. at 1465, 1466, 1469.

The industry's proposals are at odds with this interpretation. For example, the industry commenters recommend that service should be deemed to be "offered" where a multichannel video programming distributor "passes" the home. Using this interpretation could lead to anomolous results. For example, in some communities, two cable operators may have systems that pass the same house, but one operator may not be authorized, willing or able to serve the subscriber.[136] Thus,

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[135] See TCI comments at 36-37 (recognizing that one of Congress' goals is to develop a competitive market for equipment).

[136] This could happen for example, if the homes are passed by trunk and not feeder cable.

while both operators may "pass" by certain homes, they do not both "offer" service. Because they do not compete for subscribers, they do not need to charge competitive rates.

The industry also urges the Commission to count "households" based on the number of dwelling units, rather than on the number of billed or billable customers. Again, the industry's approach would distort the underlying goal of the effective competition determination. As Time Warner points out, MDU residents may pay for cable service as part of rent.[137] Thus, none of these residents actually has chosen voluntarily to receive the service. Furthermore, the fact that the MDU owner or manager has selected one service and incorporated it into rents precludes individual residents from choosing an alternative service. For purposes of determining whether a distributor provides competitive service, the Commission should look only at the number of households that actually are offered and voluntarily choose to accept the service.

In addition, industry comments suggest that the FCC should not make any determination regarding what constitutes "comparable" programming. Instead, the comments say, the Commission should assume that if people buy it, it must be competitive.[138] As the Coalition pointed out in its initial comments, this interpretation is inconsistent with findings that

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[137] Comments of Time Warner at 9-10.

[138] TCI comments at 15; Time Warner comments at 11.

cable does not face competitive alternatives.[139] For example, the fact that 15 percent of households in the franchise area subscribe to a service that offers one or two movie channels does not mean that that service is comparable to basic or expanded basic service.[140] It certainly does not mean that the operator will be forced to charge competitive rates for its tiered services. To the contrary, the fact that 15 percent choose to subscribe to a different video offering may actually suggest the offering services a completely different niche market.

C. Regulations Regarding Certification Should Reflect Congress' Desire to Provide Maximum and Immediate Protection Against High Basic Rates

As already noted, Congress wanted to ensure that cable subscribers were never forced to pay supra-competitive rates for basic service. Congress also indicated a clear preference for basic rate regulation to be conducted at the local level. See, e.g., § 623(a)(6), 106 Stat. at 1465 (allowing the FCC to regulate only until a franchising authority qualifies for certification following revocation or denial). To effectuate congressional intent, the FCC should develop regulations that facilitate local rate regulatory authority.

The Act makes clear that franchising authorities should be able to obtain authority to regulate rates without complicated filings, lengthy proceedings or unnecessary delay. The

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139 See Coalition's initial comments at 18-19.

140 Congress itself found that premium offerings were not comparable to tiered services and should not be treated the same.